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Pasadena Enterprise Zone Audit

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Pasadena Enterprise Zone Audit

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ENTERPRISE ZONE OVERVIEW

The State Enterprise Zone (EZ) Program represents California's primary economic development program. Eligibility for EZ designation is limited to jurisdictions that can demonstrate needs related to economic conditions, such as high poverty or unemployment rates. The original hypothesis behind the EZ Program is that by targeting significant economic incentives to disadvantaged communities, these communities will be more effective in competing for new businesses and retaining existing businesses. The anticipated results are increased tax revenues, less reliance on social services, and lower public safety costs. Residents and businesses directly benefit from these more sustainable economic conditions through improved neighborhoods, business expansion, and job creation.

The State Department of Housing and Community Development (HCD) is responsible for the EZ designation process and program oversight. The EZ Program, after designation, is a 15-year partnership between local governments, government agencies, non-governmental agencies and private businesses to generate new private-sector investment and growth. To assist in this partnership, the State establishes a geographical area in which businesses may be eligible for exclusive State incentives and programs, which include the following:

- tax credits for sales and use taxes paid on qualified machinery;
- tax credits for hiring qualified employees;
- a 15-year net operating loss carry-forward;
- accelerated expense deductions; and
- priority for various State programs, such as State contracts.

In addition, California Revenue and Taxation Code Section 17053.74 governs the tax credit for a taxpayer who employs a qualified employee in an EZ. The tax credit is applied as follows:

- 50 percent of qualified wages in the first year of employment.
- 40 percent of qualified wages in the second year of employment.
- 30 percent of qualified wages in the third year of employment.
- 20 percent of qualified wages in the fourth year of employment.
- 10 percent of qualified wages in the fifth year of employment.
- Cap on EZ employment tax credit of \$37,440.

By statute, all EZs are required to report on their activities relative to their goals, objectives, and commitments as stated in the application for designation and HCD's Memorandum of Understanding (MOU) with the EZ. HCD has the authority to audit, at least once every five years, any designated EZ during the duration of the designation. In addition, HCD shall, for each audit, determine a result of superior, pass, or fail, per Government Code Section 7076.1.

Pasadena Enterprise Zone Audit

Introduction

The Pasadena EZ is one of 40 EZs in the State. The Pasadena EZ offers State tax credits to stimulate business development and employment growth. Originally, the City of Pasadena received its first 15-year designation on April 10, 1992, which expired on April 9, 2007.

The new Pasadena EZ is significantly larger and covers both commercial and industrial zoned land within the City of Pasadena. In addition, the City offers local benefits to businesses located within the EZ boundaries. Both the State and local benefits apply during the existence of the Pasadena EZ, which runs from April 10, 2007 until April 10, 2022.

Unique Characteristics of the Pasadena EZ

- Actively recruits firms in the following industries: nursing and healthcare, banking and financial, retail, transportation, construction, and food and culinary.
- Processed over 2,900 voucher applications during the audit period, January 1, 2012 through December 31, 2012.
- Charges \$102 per voucher application, with \$87 being retained by the EZ and \$15 being sent to HCD.

Audit Objectives

The HCD auditors evaluated Pasadena EZ performance towards meeting the goals, objectives, and commitments, as stated in the MOU with HCD. At the conclusion of the audit process, a performance score was determined, based on Pasadena's documentation supporting its achievement of goals and objectives related to EZ administration, marketing, budgeting, vouchering, and other relevant activities [CGC Section 7076.1(b)]:

- Determine whether Pasadena is effective in the delivery of EZ program goals, objectives, and commitments.
- Determine whether Pasadena is submitting reports timely and sufficiently managing its required responsibilities.
- Determine a performance score of superior, pass, or fail based on an evaluation of the program activities, responsibilities, and other factors contributing to the their overall program performance.
- Assess compliance with EZ Act, California Code of Regulations, and HCD authorized procedures.

Audit Authority and Guidance

- Government Code Section 7070
- California Code of Regulations, Title 25, Division 1, Chapter 7, Subchapter 21, Articles 1-14
- Cal. RTC Code Section 17053.74
- HCD Management Memos
- HCD Application for Designation Guidebook and EZ Monitoring Guidebook
- EZ Application for Designation
- EZ established policies and procedures
- Internal control best practices

Pasadena Enterprise Zone Audit *(continued)*

EZ Audit Scope

- EZ MOU and MOU Supplement
- EZ performance reports
- Biennial report
- Voucher process and periodic monthly reports
- Activities and documentation available for the audit period

Audit Methodology

- Review Government Code Section 7070-7089 & 7097-7099, California Code of Regulations, HCD guidance on reporting requirements
- Review MOU, MOU Supplement and corresponding tables/exhibits
- Review Self-Evaluation report; Biennial report; monthly reports to HCD
- Review program policies and procedures
- Interview EZ personnel
- Review EZ website and partner websites

Audit Sampling Methodology

1. **Voucher Program** – To select the sample for testing, specific parameters were defined for voucher applications that were approved or denied during the period, January to December 2012.
 - Of the 2,998 total voucher applications received from January to December 2012, HCD auditors identified 70 applications for all qualifying categories (A-K) for testing. The 70 voucher applications were tested to determine if the applications met regulatory requirements.
 - For each category with five or less total applications, all were tested. For categories with over five applications, 20 percent of the population was selected. For category K, with a population of 2,149, a total of 47 applications were selected.
 - Voucher number sequence was verified to determine if voucher numbers were appropriately issued.
2. **Monthly Reporting** - comparison of January to December 2012 monthly reports to database reports to determine if fees submitted were accurate. HCD EZ auditors verified the monthly report due dates and compared that information to the actual submittal date to determine timeliness.
3. **MOU Supplement and Biennial Report** - support documentation was compared to MOU goals, objectives, and commitments to determine the level of achievement.

Pasadena Enterprise Zone's Performance Score and Adequacy of Controls

Performance Score: Pass

The audit performance score was based on Pasadena EZ documentation supporting the achievement of its goals, objectives and commitments relative to EZ administration, marketing, budgeting, vouchering, accomplishments, responsibilities, and control measures.

Note: The audit score achieved by a G-TEDA (EZ) is governed by CCR Section 7076.1, with the G-TEDA being able to achieve a score of: Superior (100 percent), Pass (99 to 75 percent) or Fail (< 75 percent). A G-TEDA audit score of less than 75 percent (below 75 percent in meeting goals, objectives, and commitment) will require a formal agreement between HCD and the G-TEDA. The agreement will be for a maximum of 180 days, by the end of which all audit findings must be remediated to retain their Enterprise Zone designation.

Adequacy of Compliance Controls

The audit of the Pasadena EZ showed there are areas of operations that can be improved. This is evidenced by the level of compliance with regulations, the MOU, and HCD policies and procedures.

Auditors noted that the following controls exist:

1. All voucher certificates were appropriately documented and approved by the EZ manager.
2. Roles and responsibilities of the EZ staff are defined.
3. Voucher processing policies and procedures exist and are being followed.
4. Voucher records are retained for five years.
5. Monthly reports and fees are sent timely to HCD.
6. Pasadena EZ is tracking achievements made in the areas of business expansion, attraction, retention, and marketing/sales strategies and reporting this information in compliance with the MOU.

Pasadena EZ could improve operations in the following areas:

1. Self-Evaluation reporting
2. EZ management of the program
3. Biennial reporting compliance
4. Timeliness/Accuracy of EZ Voucher Reporting/Fees

Pasadena Enterprise Zone Audit Finding Log

Pasadena EZ's log of audit findings includes the compliance or control issue, how the issue was noted, and the criteria/risk that should be complied with or managed, and suggested recommendation. The Audit Finding Log records Pasadena's Action Plan, documentation requirements, the action owner, and the estimated Action Plan completion date.

A G-TEDA audit score of 99 to 75 percent will require that HCD EZ Audit team track all audit findings for resolution and submission of completion documentation. The EZ Audit team may also perform follow-up testing.

#	Issue/Significance (Risk)/Root Cause	Action Plan	Action Owner	Estimated Completion Date
1	<p><u>Self-Evaluation</u></p> <p><u>Findings</u></p> <ol style="list-style-type: none"> 1. The Pasadena EZ does not have a sufficient self-evaluation process in place to assess the effectiveness of the EZ's marketing activities, financing programs, job development, planning and local incentives and program management as stated in the application, MOU and MOU Supplement. 2. The Pasadena EZ does not have adequate supporting documentation of the self-evaluation process to verify: <ul style="list-style-type: none"> o If regular monthly assessment activities have taken place. o If and what services were rendered to businesses. o To determine strengths and weaknesses in the areas of marketing activities, financing programs, job development, planning and local incentives and program management. o To determine areas of improvement. 	<ol style="list-style-type: none"> 1. Based on the feedback from the Audit, the Pasadena Enterprise Zone will begin to report out the goals and objectives attainments for each Plan separately on the quarterly, annual and biennial reports instead of in a "lump sum" format. This will provide a better reflection of the services provided by the Pasadena Enterprise Zone and identify areas that need improvement. 2. Additionally the Pasadena Enterprise Zone will submit a letter to the Department of Housing and Community Development requesting a language change in Pasadena's MOU supplement. Under each of the self-evaluation plans, Pasadena indicated that the review of each plan will occur monthly. Although the services and the evaluations are conducted monthly, Pasadena does not have a formal tracking log of monthly services. Instead these Program activities are recorded quarterly to determine strength and weaknesses in services and provide trends between quarters. The 	Melissa Alva	May 30, 2013

#	Issue/Significance (Risk)/Root Cause	Action Plan	Action Owner	Estimated Completion Date
	<p><u>Criteria</u> CGC 7076.1(b); Pasadena's EZ application, MOU and MOU Supplement</p> <p><u>Recommendations</u></p> <ul style="list-style-type: none"> Pasadena EZ should implement a self-evaluation plan to assist with fully assessing the effectiveness of the Pasadena EZ's performance and activities on a regular basis. Quarterly activity of self-evaluation should be conducted and documented. 	review of each quarter's activities is summarized in the Zone's annual reports and eventually within the biennial reports.		
2	<p><u>Efficient Management of the Program</u> Management of the Pasadena EZ does not include second-level management review of activities.</p> <p><u>Finding</u> 1. Pasadena EZ Manager performs and implements all phases of the EZ Program. However, there is no procedure in place for second-level management review.</p> <p><u>Criteria</u> GC Section 7076.1(b); Pasadena's EZ application, MOU and MOU Supplement.</p> <p><u>Recommendation</u> Pasadena should incorporate a second-level management review internal control. It would provide for increased oversight and management accountability on EZ results.</p>	1. With the corrective action identified in PAO #002-2013; referral LDW-1, the Zone Manager will better identify the met goals and objectives of each Plan within the quarterly, annual and biennial reports, which will provide additional information to the Zone Manager's supervisor for additional review.	Melissa Alva	May 30, 2013
3	<p><u>Biennial Report</u> Although Biennial reporting is a requirement, HCD issued guidance that allowed the EZs to do minimal performance reporting on their goal and objective</p>			

#	Issue/Significance (Risk)/Root Cause	Action Plan	Action Owner	Estimated Completion Date
	<p>achievements.</p> <p><u>Findings</u></p> <ol style="list-style-type: none"> 1. Pasadena provided supportive documentation on achievements and specific activities that the EZ had completed whether the activities were ongoing or planned in order to meet its goals, objectives, and commitments per the MOU. This information, however, was not included in the biennial report. 2. Review of the latest Biennial Report dated 2009-10 and 2010-2011 does not fully report relative goals, objectives and commitments of the original application and MOU. <p><u>Criteria</u></p> <p>CGC 7085.1; HCD Management Memo 12-01- G-TEDA Biennial Reporting ; HCD Management Memo 10-04 - Biennial Reports</p> <ul style="list-style-type: none"> • The biennial report should include activities relative to the goals, objectives, and commitments as stated in the original application for designation and MOU. • Identification of previous 2 years' funding for cash and in-kind. This should also include current and following fiscal year (FY). <p><u>Recommendation</u></p> <ol style="list-style-type: none"> 1. Pasadena must ensure that required components of the biennial report, all parts of the MOU, are addressed and reported to meet regulatory requirements. 	<ol style="list-style-type: none"> 1. As identified through the Audit, the practice of providing the figures as a "lumped sum" is not an acceptable format for the biennial report. To better comply with California Government Code Section 7085.1(a), Pasadena will revert to the format used in the first biennial report and use the MOU supplement as the basis of responding to each goal and objective under each Plan. 	Melissa Alva	April 9, 2013

Audit Observation

HCD's audit of the Pasadena EZ brought to light areas involving HCD process controls that are noteworthy:

- The audit cited Pasadena EZ for a non-compliant biennial report. PEZ, however, provided a copy of a memo from the California Association of Enterprise Zones President, sent to all EZs dated September 21, 2012, stating, "HCD has agreed to accept this brief report as satisfying the reporting requirement in full". The regulations are clear on the expectations for biennial reporting. HCD EZ Program should ensure that the regulations are adhered to and consistently followed.